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September 1, 2000

Mary L. Cottrell, Secretary
Department of Telecommunications and Energy
One South Station, 2nd Floor
Boston, Massachusetts 02110

Re: Notice of Standard Offer Adjustment – Boston Edison Company, Cambridge Electric Light Company, Commonwealth Electric Company

Dear Secretary Cottrell:

Boston Edison Company ("Boston Edison"), Cambridge Electric Light Company ("Cambridge") and Commonwealth Electric Company ("Commonwealth", together, the "NSTAR Companies") hereby notify the Department of Telecommunications and Energy (the "Department") that they will implement, on November 1, 2000, the Standard Offer Adjustment set forth in the existing, Department-approved tariffs of the NSTAR Companies. As described below, the amount of the increase for the month of November will be 0.581 cents per kilowatt-hour ("kWh") for Boston Edison, and 0.650 cents per kWh for Cambridge and Commonwealth.

- **The Standard Offer Adjustment for Fuel Cost Increases (the "Standard Offer Fuel Index Adjustment")**

The Standard Offer Fuel Index Adjustment is an integral part of the Department-approved restructuring plan of Cambridge and Commonwealth and the restructuring settlement for Boston Edison. See Boston Edison Restructuring Settlement, Attachment 4, at 262-264 (Appendix A; hereto); and Cambridge/Commonwealth Restructuring Plan, at 33 (Appendix B, hereto).[1] In accordance with these approved plans, each of the NSTAR Companies has a tariff in place that implements the terms of the Standard Offer Adjustment. See Boston Edison Tariff MDTE No. 912 (Appendix C, hereto); Cambridge Tariff MDTE No. 658 (Appendix D, hereto); and Commonwealth Tariff MDTE No. 405

[1] These provisions were agreed to by a wide range of parties and interests in the Boston Edison restructuring settlement (including the Attorney General and the Division of Energy Resources). No party objected to these provisions during the adjudication of the Cambridge and Commonwealth restructuring plan. Additionally, similar provisions were included in the restructuring settlements approved for Massachusetts Electric Company and Eastern Edison Company.

(Appendix E, hereto). As described in the Boston Edison Restructuring Settlement, the Standard Offer Fuel Index Adjustment is designed to be implemented:

> if there are substantial increases in the market prices of No. 6 residual fuel oil (1% sulfur) and natural gas after 1999…. If invoked, prices would change as a function of the amount by which market fuel prices exceed the predetermined price "trigger" levels. These triggers have been set to allow a large dead-band in which no increases…would apply.

Boston Edison Restructuring Settlement, Appendix 4, at 262.

The Standard Offer Fuel Index Adjustment provisions were established in restructuring plans in anticipation of the possibility that significant increases in the price of fuel oil and natural gas would increase the price of electrical generation used to provide standard offer service to customers. In each case, the approved restructuring plan includes a schedule of retail prices for standard offer service from 1998 through the expiration of standard offer service in 2004. Boston Edison Company, D.P.U./D.T.E. 96-23, at 15, 20 (1998); Cambridge Electric Light Company/Commonwealth Electric Company, D.P.U./D.T.E. 97-111, at 16, 23 (1998); Cambridge Electric Light Company/Commonwealth Electric Company, D.T.E. 98-78/83-A, at 31 (1998). As described in more detail below, the Standard Offer Fuel Index Adjustment permits an increase in the retail rates for standard offer service if there are larger-than-anticipated increases in the cost of fuel oil and natural gas.

The adjustment clause serves several purposes. It recognizes that if the price of fuel and natural gas increases significantly, the cost of generation also increases.[2] In the absence of the collection of the surcharge established by the Standard Offer Fuel Index Adjustment, fuel-related increases in the price of generation will create deferrals of costs, thus necessitating the subsequent imposition of surcharges and the collection of carrying charges from customers. The current implementation of the Standard Offer Fuel Index Adjustment will also result in a total standard offer price that more closely tracks the market price of electricity. Current sizeable increases in fuel costs have, in part, increased the market price of electricity, and by implementing the adjustment now, standard offer rates will also rise. This should allow marketers of electricity to compete with the standard offer price more effectively, resulting in a more rapid development of the competitive power market, the benefit of which was the primary objective of industry restructuring.

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[2] Each company has divested virtually all of its generating plants and replaces this power with buy-back contracts, some of which include this fuel index, or with short-term purchases from the market.

- **The Standard Offer Fuel Index Adjustment Formula**

The formula for the Standard Offer Fuel Index Adjustment included in the tariffs is straightforward and mechanical. It computes a surcharge on the rate for standard offer service based on whether the twelve-month average of gas and oil prices (as defined in the formula) exceeds the annual predetermined "trigger point." This trigger point, which increases each year, represents a substantial "deadband" to ensure that the surcharge is implemented only if there is a significant, larger-than-anticipated increase in fuel prices. <u>See</u> Boston Edison Restructuring Settlement at 262-264 and identical tariff provisions cited above for each company.

The gas prices are taken from specified prices (expressed as dollars per MMBtu) published in the <u>Wall Street Journal</u> for the New York Mercantile Exchange for the sale and purchase of natural gas at Henry Hub, adjusted for a basis differential for transportation to New England. Similarly, the price of oil is the average for the month of the daily low quotations for cargo delivery of 1.0% sulfur, No. 6 residual fuel oil into New York Harbor as reported in <u>Platts Oilgram</u> U.S. Marketscan in dollars per barrel, converted to MMBtu by dividing by 6.3, and adjusted by a transportation factor for delivery to New England. The sum of these two calculations is then divided by the specified, annual fuel trigger factor, adjusted by a transportation factor. If the result (the "Fuel Adjustment") is more than 1.0, it is multiplied by the Department-approved standard offer rate to determine the per-kWh Standard Offer Fuel Index Adjustment.

The calculation for the fuel indices and the Standard Offer Fuel Index Adjustment for 2000 is set forth in Appendix F, hereto. As shown in Appendix F, through August, the Market Gas Price is $3.069/MMBtu, the Market Oil Price is $3.4870/MMBtu and the resulting Fuel Adjustment is 1.2013. When this factor is multiplied by the Boston Edison base standard offer rate of 3.4 cents per kWh, the base standard offer charge is increased by 0.684 cents per kWh, to 4.084 per kWh.[3] The base standard offer charge for Cambridge and Commonwealth is 3.8 cents per kWh. Multiplying the Fuel Adjustment factor by 3.8 cents computes an increased standard offer charge of 4.565, an increase of 0.765 cents per kWh. Although the Standard Offer Fuel Index Adjustment computed as set forth in Appendix F can be implemented in full, the NSTAR Companies recognize that the total rates charged for customers on standard offer service are further constrained by the legislative mandate of a 15 percent, inflation-adjusted rate reduction. As described below, the level of the Standard Offer Fuel Index Adjustment that will be implemented as of November 1, 2000, complies with that cap.

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[3] Boston Edison also has in effect a standard offer surcharge of 1.1 cents per kWh, which is added to the base standard offer charge.

- **Compliance with the 15 Percent, Inflation-Adjusted Rate Reduction**

G.L. c. 164, § 1B(b) requires that as of September 1999, the total rates paid by customers taking standard offer service be at least 15 percent lower than the inflation-adjusted rate in effect before electric industry restructuring, as established by the Department.[4] The Department is vested by the Restructuring Act with discretion to review and approve the inflation cap to ensure that "the economic value of the rate reduction required under this section, be maintained during the standard service transition rate period." G.L. c. 164, § 1B(e). The statute does not define how the inflation cap is determined and the Department, therefore, must consider the reasonableness of a proposed measure of inflation as part of its review process.

Before the necessity of instituting the Standard Offer Fuel Index Adjustment, the inflation adjustment that was applied to determine whether rates complied with the 15 percent rate reductions was the consumer price index ("CPI"). See, e.g., Department Letter Order to Electric Distribution Companies, dated December 17, 1999, at 5-6. This is an appropriate "general" measure of inflation and the Department in adopting CPI was not faced with the issue of considering the impact of the fuel adjustment on the inflation calculations. But now that there has been "extraordinary" inflation for electricity prices based on the larger-than-anticipated inflation in fuel costs, it is necessary to include electricity-specific inflation in the inflation computation. This is both consistent with the intent of the Restructuring Act (Chapter 164 of the Acts of 1997) and the restructuring settlements and restructuring plans approved by the Department.

For example, the settlement agreement for Boston Edison (as well as those for Massachusetts Electric Company and Eastern Edison Company) includes provisions to ensure that customers receive the rate reductions that were an integral part of the settlement agreements. The allowed price increase was based on pre-restructuring prices adjusted by the CPI index less 10 percent plus any extraordinary fuel price increases as reflected in a fuel index. See, e.g., Boston Edison Restructuring Settlement, Section I.B.9, at 033-034. This approach is equally applicable to determining compliance with the 15 percent rate reduction included in the Restructuring Act, which is intended to maintain the economic value of the rate reduction.

Applying the CPI and the fuel-index inflation "adder" results in a conservative, appropriate inflation factor, consistent with the intent of the Restructuring Act and the restructuring plans and settlements approved by the Department. It is a composite inflation index that was agreed by the numerous settlement parties to the Boston Edison, Eastern Edison Company and Massachusetts Electric Company settlements. The inclusion of the fuel index in computing inflation assures that customers continue to receive the 15 percent rate-reduction benefits from restructuring since, in the absence of

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[4] Prior to September 1999, the rate reduction was to be at least 10 percent. Id.

industry restructuring, the fuel clause would have adjusted electricity rates to incorporate increased fuel costs. The method of implementing the inflation cap calculation is to apply the CPI index to all components of the overall price, but to apply the fuel index to the Standard Offer portion only.[5] This is shown in the calculation of inflation set forth in Appendix G, which complies with the restructuring settlements by implementing the composite inflation index approved in the company settlements.

Appendix G, hereto, computes the inflation adjustment for each of the NSTAR Companies by adding the Standard Offer Fuel Index Adjustment to the CPI-based inflation adjustment to increase the total price against which the rate reduction is measured. Appendix G demonstrates that, for each company, the total revenues for customers taking standard offer service reflects at least a 15 percent reduction from the inflation-adjusted rates. Column A computes the per-kWh average rate before restructuring. Column B is the Department-approved, CPI-based inflation factor presently in effect for each company. Column C computes the overall inflated price by summing: (1) the pre-restructuring price adjusted by the CPI; and (2) the fuel-index adjustment. Column D computes the percentage reductions in the prices that will be in effect in November (Column E) and demonstrates that the overall level of rates for each company is at least 15 percent below the inflation-adjusted rates.

- **Standard Offer Fuel Index Adjustment for November 2000**

In order to ensure that the rates for standard offer service receive an inflation-adjusted 15 percent reduction, the NSTAR Companies are not implementing the full increases that would be allowed by the Standard Offer Fuel Index Adjustment for the month of November. To maintain the reduction, the maximum increases are reduced by 15 percent. Accordingly, the standard offer rate for Boston Edison shall be increased by 0.581 cents per kWh. The increases for Cambridge and Commonwealth will be 0.650 cents per kWh.

Appendix H, Appendix I and Appendix J, hereto, demonstrate that the rates for each rate class for each of the NSTAR Companies comply with the 15 percent inflation-adjusted rate decrease. In each Appendix, Column A is the retail revenues before restructuring. Column B inflates those retail revenues by the CPI inflation index. Column C computes the additional inflationary impact of the Standard Offer Fuel Index Adjustment. Column D adds Columns B and C to compute the total inflation-adjusted revenue. Column E computes the total revenues, applying the November 2000 rates. Column F calculates the percentage reductions by dividing the dollar reduction (Column E minus Column D) by Column D. In every case, the inflation-adjusted reduction is at

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5 This ensures that this measure of inflation moves in tandem with increases in the standard offer charges, so that only customers paying for standard offer generation will be affected by the inflation adjustment.

least 15 percent. Column G shows the retail revenues under the existing rates and Column H computes the percentage increase for each class for the November adjustment.

The NSTAR Companies intend to file, on a monthly basis, a Standard Offer Fuel Index Adjustment, with supporting documentation in the format set forth in Appendices F through J, as long as the relevant fuel adjustment index is greater than 1.0.

Any correspondence with regard to this notice should be directed to the following:

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Thank you for your attention to this matter.

Sincerely,

Robert N. Werlin

Enclosures

cc: Ronald LeComte, Director, Electric Power Division
Kevin Brannelly, Director, Rates and Revenue Requirements Division
Paul Afonso, General Counsel
George Dean, Assistant Attorney General
David O'Connor, Commissioner